AN INTERVIEW WITH PAUL O'NEILL (October 30, 2008)

Paul O'Neill says he enjoyed being the 72nd secretary of the U.S. Treasury (2001 2002), even though the job lasted only 23 months. O'Neill, who has been analyzing the U.S. budget since he went to Washington, served in the Bureau of the Budget, which later became the Office of Management and Budget in the White House.

O'Neill came to American government in 1961 as a management intern, and stayed for 16 years through the Kennedy, Johnson, Nixon, and Ford administrations. The last 10 years of his tenure were spent at what was the Bureau of the Budget, which became the Office of Management and Budget. There he became deeply involved in the issues of fiscal policy, budget balance, budget making, and helping presidents choose priorities for how we spend the nation's money.

Then he moved to the private sector in 1977. In 2000, he was asked by President Bush 43 to come back to the government and be the Secretary of the Treasury, which he did for 23 months before he got fired for having a difference of opinion.

Q: When you took over at Treasury, how would you characterize the financial health of the United States? Are you surprised at where we are today?

Paul O'Neill: When I moved into the Treasury as the 72nd secretary, what we inherited from the Clinton administration was an economy that had been rolling itself into a modest recession for a year and a half. By that time, the dot-com bubble had burst and the economy had slowed down, and we actually had some negative quarters that we didn't really know about until Clinton was gone and Bush 43 was in charge. But on the fiscal policy front we were in a condition where we had, for the first time in a long time, a budget that was in surplus.

I have to hasten to add that while it was in surplus, it was not in surplus on a federal funds basis. It was only in surplus because the trust funds were bringing in a lot of money and together, with federal funds and the trust funds, the Clinton administration was able to claim three years of budget surpluses, which we hadn't seen since 1969. That was a year where we were in budget surplus with the use of the trust funds. The last year I think that we were actually in surplus on a federal funds basis, without using trust fund money, was in 1960, so we'd been at this now for 47 years of basically living beyond our means especially if you think federal funds ought to be in surplus without using the trust fund money to calculate balance.

So in 2001, when Bush 43 took over and I took over at the Treasury, we were in a total surplus condition, and arguably (I think this was a correct argument) we needed to reduce taxes because taxes had crept up to the point where something like 20 or 21 percent of the GDP was being effectively taken by federal government. Traditionally, our level has been someplace around 18 percent or maybe 18.3. So I think it was correct to say that we could afford to have a tax cut, which President Bush 43 had run on in the 2000 election, and he set out to deliver what he promised in

the election and I think that was okay. The reason that I agreed to come in as Treasury secretary was because I saw lots of things in our economy and our society that needed to be done, and I was encouraged to believe that Bush 43 was up for the difficult political things that needed to happen to make course corrections. Those course corrections still include fixing the Social Security and Medicare trust funds, and fundamentally redesigning the way the federal tax system works. I thought there was some prospect that President Bush would entertain the difficult political choices that needed to be made in order to act on these things, and I spent a lot of time thinking about these things over a period, better part of 40 years, so I was anxious to have a go at it.

Q: How did it go?

Paul O'Neill: The first part was the easiest part. Cutting taxes is always a cinch it's only a debate about who gets the credit and how big the cut is. But then we had 9/11 and it really changed where we were. The economy was still slow, although we were actually having positive growth in the fourth quarter of 2001.

But there was still a lot of energy and President Bush himself was bringing this energy that we need additional tax cuts. I honestly didn't think that was the right thing to do, because I continue to believe we needed the revenue that we were then collecting to work on the Medicare/Social Security problems. To work on fundamental tax redesign after 9/11 while worrying about whether there was going to be another attack or a series of attacks would cost hundreds of billions of dollars. So I was against further tax reductions at the time, especially as we got into 2002, as I became more concerned that we were also going to need money since it looked to me like we were sliding into a war with Iraq. I argued during the second half of 2002 we should not have another tax cut because we need the money to work on important policy issues that would shape the nation going forward, and we needed to have, in effect, rainy day money for the prospect of Iraq and another set of attacks like 9/11.

That was not a popular view, and in fact, it led to a conversation with the vice president where he basically told me, "Don't worry about further tax cuts, it's okay. Ronald Reagan proved that we don't have to worry about deficits." Which is really a shock to me because whatever you may think about Ronald Reagan, I don't think he or anyone else has proved that it's possible to ignore not just deficits, but federal debt as well. I think it is true that you can be sanguine about deficits for a short period of time, but you can't be sanguine about mounting debt for the United States of America. When we, the Bush 43 administration took over, we had something over $ 5 trillion, maybe $ 5.6 trillion worth of national debt. Today [Fall 2007] I think the number's $ 8.8 trillion. That's not an innocent change, it is a monumental change in the debt service that we have to do in addition to and on top of all of the other things that our country needs to do.

Q: Toward the end of 2002, you wrote a report that said that the current debt wasn't the problem; it was the debt that we are stepping toward. Shortly thereafter you were asked to leave. Can you explain to me what happened the day you were fired?
Paul O'Neill: During 2002 I found myself being at odds with where policy

seemed to be going, I kept arguing that we couldn't really afford another tax cut and that we didn't need one, since the economy was doing fine. But my problems were not just differences about tax policy and social policy and fixing Medicare and Social Security. I kept asking almost every week, of the people from the CIA who briefed me, you know, where's the evidence for weapons of mass destruction? I see all of these allegations and projections of trends from 1991 and what we knew in 1991, but I didn't see anything I considered to be evidence. One of the things I've been trained to do for a long period of time is to know what you know and to differentiate that from what you suspect or what someone alleges, so I kept being a pain in the neck and asking, "Where's the evidence? There's no evidence, there's nothing I believe."

Early in the administration, at a National Security Council briefing, there were a bunch of photos put on the table and it was alleged that this satellite picture of what looked like a warehouse that you could find anywhere in the world was a production center for weapons of mass destruction. I said, I've spent a lot of time going around the world, producing goods all over the world, and have seen a lot of factories and warehouses. How can you tell me this one is a center for producing weapons of mass destruction? There's nothing here that tells you that? You may assign it that, but there's nothing here that tells you that.

One of the things I found really interesting out of this experience is that even today, people that I have a lot of regard for their intellect, like Bill Clinton, still say they believed the evidence was there. I've never had this conversation with him, but it's hard for me to believe a guy who's as smart as he is doesn't know the difference between an allegation and evidence especially someone who's trained as he is as a lawyer. I've been astounded, this is a bipartisan thing people on both sides don't seem to get the difference between evidence and what they call intelligence, which I would call not intelligence, just a bunch of fabrications. So I was working my way to the margins of what endurance that people had for me, both in economic policy and in everything else I encountered. I have to admit some of the things that I said during this period probably ought to have been tempered. For example, we were struggling with trying to get the International Monetary Fund and the World Bank out of the business of effectively bailing out private sector lenders who'd given money to developing countries with the expectation that the people of the United States and other tax-paying people around the world would bail out the private sector lenders. I said (probably not very advisedly), "Before we give any more money to Argentina, we ought to make sure it's not going to go to a Swiss bank account."

Which was, I admit, not very diplomatic, but it was true and interestingly enough, in a few weeks a guy who had been the president of Argentina said, without any prompting from me, "Well it was true he had money in a Swiss bank account, but it was all his own."

So in any event, as we moved past the election in 2002 and we had this continued conversation, a really heated conversation with the vice president about what I considered to be the inadvisability of a further tax cut, I got a call, early in December. I was in my office having a meeting with a group of people and my secretary came in and said, "The vice president's on the phone and would like to talk to you. The vice

president said, "The president's decided to make some changes, and you're one of the changes. What we'd like to do is have you come over and meet with the president and basically say that you've decided to go back to the private sector, that you're ready to quit your involvement with the Treasury."

I said I didn't think I needed another meeting with the president, thank you very much. I thought I'd had plenty of meetings, and I thought he probably didn't need a meeting and I certainly didn't need a meeting. And I also said to him, "You know, I've been going along now for 65 years or so and, you know, for me to say that I've decided to leave the Treasury to go back to the private sector is a lie, and I'm not into doing lies. And so what I want to do is issue a press release tomorrow morning before the markets open so that they'll have time to digest this news in case it creates any stir. And I'll send the president a note telling him I'm resigning."

And I think he was surprised by that. He didn't try to argue me out of it, I think probably because he'd known me long enough to know that it wouldn't do any good, that I'd made up my mind and that was it.

Q: What did it feel like to get fired?

Paul O'Neill: Well, it's a first in my life I'd never been fired before, I'd only been promoted to ever-higher levels of responsibility. But it was okay with me because I would have really been uncomfortable arguing for policies I didn't believe in. One of the things I actually said to President Bush and Vice President Cheney when they asked me to come and have lunch with them, and to ask me to serve as the secretary of the Treasury, was that I had reservations about doing this. And one of the reservations I had was that, having been the CEO of a very big corporation for 13 years and the president of a very big corporation for the period before that, I wasn't sure how easy it was going to be for me to knuckle under when I thought the policy was wrong. The thing I didn't know is how difficult it would be to knuckle under if you thought the policy was not well vetted, that it was decided on the basis of ideology instead of what was right for the country. At that point I really thought the decisions were not being made on the basis of what was right for the country, they were being made on the basis of what was right for getting reelected.

It's probably altruistic, but I thought for a long time we need presidents who are so devoted to doing the right thing with and for the American people that they're prepared to lose for their values and to hang their values out in public for everyone to see them.

Q: Let's revisit the conversation that you had with Vice President Cheney prior to you being fired. Can you discuss the difference of opinion that you had in regard to tax cuts and deficits?

Paul O'Neill: Sometime after the election it must have been mid-November there was a meeting of the Economic Policy Group, including the vice president. As we sat at the table in the Roosevelt Room, we talked about where we were and where we were going. If I remember right, Glenn Hubbard made a presentation that was displayed on the screen at the front of the Roosevelt Room and showed where we were going and what different tracks

looked like and GDP growth and the rest, including the effects of the proposed third tax cut. I made the argument, which I had been making over and over again since maybe June or July, that it was not advisable to have another tax cut because of the need to fix Social Security and Medicare and to have some money to smooth the fundamental redesign of the tax system. We needed to have in effect rainy-day money in the event that we had another 9/11 event and at that point it looked like maybe we were going to go to Iraq, and it was not going to be cheap to do that.

So I argued that we should not have another tax cut because the economy was going to be in positive territory and doing okay through the next couple of years anyway without another tax cut, and there were all of these other compelling reasons not to risk a deficit and not to risk adding more to the national debt. And the vice president basically said, "When Ronald Reagan was here, he proved that deficits don't really matter and so it's not a consideration or a good reason not to have an additional tax cut." I was honestly stunned by the idea that anyone believed that Ronald Reagan proved in any fashion, certainly not inconclusive fashion, that deficits don't matter. I think it is true on a temporary basis that a nation can have a deficit and have a good reason for having a deficit. I think the Second World War there was no way we could avoid having a deficit, but when we came out of the Second World War we started running budget surpluses again and did that through the '50s and into 1960. It's interesting, it's really only been in the last 40 years or so that we've accepted the notion that it's a bipartisan thing that we don't have to have fiscal discipline.

A year ago there was this signing ceremony in the Rose Garden for the new Medicare prescription drug entitlement, and it's going to cost us trillions of dollars. This event was not unlike any of the others in the Rose Garden on a nice sunny day, with the president sitting at the signing table with a bunch of grinning legislators behind him taking credit for this "great gift" they're giving the American people. But none of their money was going to get given to make this happen, because the federal government doesn't have any money that it doesn't first take away from the taxpayers.

There was no mention of the fact that this in effect was a new tax on the American people, and we didn't know how we were going to pay for it. It was only grinning presidents and legislators taking the credit for a gift, which strikes me as a ridiculous continuing characteristic of how we do political business in our country.

Q: If we couldn't afford it, why did we give it to the people?

Paul O'Neill: If you can get 51 percent of the people in the Congress to agree with the President's leadership initiative to say we ought to do this, that's all it takes. And I think it's regrettably true there are a lot of people who don't understand that when they get a gift from the American people, it's from the American people and it can only be paid for with taxes over time. I think the confusion is aided and abetted by the fact that it doesn't feel like we're paying for it. It's a lot like running up credit card debt: As long as you can pay the interest charges on your credit card debt, you can live way beyond your means. In fact, we as a nation are living way beyond our means, and for a period of time,

there's no doubt we've demonstrated you can get away with it. But I think we only need to look at the fate of other countries who've lived beyond their means for a long time to see you inevitably get into trouble.

If you look at Germany in 1923, they got to a point where their currency was so worthless that you needed a wheelbarrow to haul the currency that was needed to buy a loaf of bread. You get inflation where people stop investing in your national debt, when they say, "We're not going to loan you money because you're not going to be able to pay it back." It's the same thing that happens to individuals and families. When you get extended to the point that you can't service your debt, you're finished.

You know, so you go through a calamity either you go through a terrible inflation, which is a way of having a national bankruptcy, and you destroy accumulated income and wealth, and in fact you have a taking from all the people because suddenly their financial assets are worth nothing. You know, are we going to have that right away? No. But should the people who are in positions of political leadership know that and anticipate it and do something about it for the American people, you bet and now is the time to begin doing something about it.

One of the difficult aspects of this debt problem is that it's not very transparent to people who are unschooled in fiscal and monetary policy. In a way, this problem's a little bit like the famous example of if you throwing a frog into boiling water. If you throw him into the already boiling water, he jumps out right away. But if you put the frog in the pot of cold water and turn the heat on under it, the frog will let itself be boiled because it doesn't respond to slow increase in temperature. Our debt problem is something like that. If we wait until we have a calamity and financial markets shut us off because we've exhausted their belief that we can service additional debt, it's too late.

This is a problem that we need to deal with without letting the heat be turned up some more.

I would hope we can demonstrate we're intelligent people that don't wait until they create a calamity in their country before they deal with problems that are obvious to anyone who's ever studied economic policy and fiscal policy and monetary policy. You only need to look around the world to see places like Argentina, Turkey, and Germany after World War II whose governments have effectively achieved a meltdown condition. Knowing this can happen to modern nations, we should not let it happen to ours.